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UNITED STATES TAX COURT

ESTATE OF WILLIAM L. RENO, JR., BARBARA G. RENO, EXECUTRIX, Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 16511-82. Filed April 21, 1986.

James L. Malone, III, for the petitioner.

Vikki Pryor, for the respondent.

MEMORANDUM OPINION

WRIGHT,* Judge: By notice of deficiency dated April 7, 1982, respondent determined a deficiency in petitioner's Federal estate tax in the amount of $253,656. A portion of this deficiency resulted from respondent's reduction of the marital deduction by $25,981. After concessions, the sole issue for

* By order of the Chief Judge, this case was transferred from Judge Edna G. Parker to Judge Lawrence A. Wright.

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decision is whether the Federal estate taxes on certain Kentucky real estate are to be borne by such real estate or by decedent's non-probate property.

All of the facts have been stipulated and are so found. The stipulation of facts and exhibits thereto are incorporated herein by this reference.

Petitioner herein is the Estate of William L. Reno, Jr. (decedent). Decedent died testate on October 8, 1978. A Federal estate tax return was filed by decedent's estate on July 12, 1979. At the time the petition in the instant case was filed, Barbara G. Reno, the executrix of decedent's estate, resided in Falls Church, Virginia.

Decedent was a professor of jurisprudence and was active in the management of his own business affairs. He was also involved in the active management of his family's financial affairs and administered the estates of several family members. During his lifetime, decedent filed approximately 5 estate tax returns and 40 gift tax returns. He was familiar with the Federal estate tax system in general and with the marital deduction provisions.

The will which was operative at the time of decedent's death was signed by decedent on September 1, 1978. This will, except for the name of the contingent beneficiary, is identical to a will signed by decedent on October 5, 1972. Neither of these wills contained any reference to the Federal estate tax marital deduction. Five earlier wills, however, contained provisions

which would result in the maximum marital deduction for Federal estate tax purposes. These wills, all of which were revoked by the decedent, were dated August 31, 1949; July 12, 1951; October 19, 1954; August 31, 1955; and March 1, 1957.

At the time of his death, decedent's gross estate included both probate and non-probate property. The probate property consisted of substantial real estate interests in and around Owensboro, Kentucky, as well as various bonds and miscellaneous property. The non-probate[1] property, which decedent held with his wife as joint tenants by the entireties, consisted of real property in Falls Church, Virginia, and a checking account. In his will, decedent provided that the Kentucky real estate be left to his wife, Barbara G. Reno, for and during her natural life, with the remainder in fee simple to his daughter. In the same paragraph decedent provided as follows:

> I direct that all death duties on this Kentucky real estate ascertainable at my death be paid by my Executrix out of the assets of my estate other than Kentucky real estate.

At the time decedent executed his will in 1972, the value of the residue of his probate estate (bonds and miscellaneous property) was sufficient to pay the Federal estate taxes on the Kentucky real estate. During the period from 1972 to 1978, however, the value of the Kentucky real estate increased while

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1 The terms "probate property" and "non-probate property" are used herein solely for convenience, and are not legal descriptions of the property in issue. See infra pp. 10-11.

the value of the residue of the probate estate, specifically the corporate bonds, remained constant or decreased. The bonds and other miscellaneous property which constituted the residue of decedent's probate estate were left outright to his wife. These assets were valued at $102,665 for Federal estate tax purposes. This sum is less than the Federal estate tax and state inheritance tax liabilities and the administration expenses incurred by decedent's estate.

On April 7, 1982, respondent mailed a statutory notice of deficiency to petitioner. In the notice of deficiency, respondent determined a deficiency in estate tax due from petitioner in the amount of $253,656. Respondent reallocated the taxes on the Kentucky real estate to the non-probate property, thereby decreasing the amount of such property eligible for the marital deduction. This determination resulted in the reduction of the marital deduction under section 2056[2] by $25,981. Respondent's determinations are presumptively correct, and petitioner bears the burden of proof with respect to the claimed deduction. Rule 142(a).[3]

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2 All section references are to the Internal Revenue Code of 1954, as amended and in effect during the year here in issue, unless otherwise indicated.

3 All rule references are to the Tax Court Rules of Practice and Procedure, unless otherwise indicated.

The sole issue for decision is whether, under Virginia law, the Federal estate taxes on the Kentucky real property are to be borne by the Kentucky real property or by the non-probate property. If such taxes are paid by the non-probate property, the amount of the estate tax marital deduction will decrease, thereby increasing the estate tax liability of petitioner. Petitioner argues that, in the absence of sufficient funds in the residue of decedent's estate to pay the taxes on the Kentucky real estate, the real estate must bear its proportionate share of the Federal estate taxes and state inheritance taxes, thus giving effect to the legislative intent behind the Virginia apportionment statute and affording petitioner the full benefit of the marital deduction. Respondent argues, however, that the will provision is evidence of the decedent's intent to preserve the Kentucky real estate, even if such preservation results in a reduction of the marital deduction.

Decedent's will was submitted to probate in Virginia.[4] Under Virginia law, the general rule with regard to the payment of estate taxes is that estate taxes are apportioned against the asset which produces the tax. Va. Code sec. 64.1-161 (1980).

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[4] The parties agree that Virginia law controls the placement of the estate tax burden in this case.

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The Virginia Code provides that each beneficiary's share shall be charged with Federal estate taxes and state inheritance taxes in the proportion that the value of such share bears to the total value of the estate, "except that in making such proration each such person shall have the benefit of any exemptions, deductions and exclusions allowed by such law in respect of such person or the property passing to him[.]" Va. Code sec. 64.1-161 (1980). This statute was designed to give the surviving spouse the full benefit of the marital deduction unless the decedent directs otherwise by will or other inter vivos instrument. Alexandria National Bank v. Thomas, 213 Va. 620, 194 S.E. 2d 723, 725 (1973); Baylor v. National Bank of Commerce, 194 Va. 1, 17, 72 S.E. 2d 282, 285 (1952).

The testator, however, retains the power and the right to direct payment of Federal estate taxes and state inheritance taxes, by will or by other inter vivos instrument, and to designate the funds from which payments of such taxes shall be made. If the testator makes such direction, the provisions of the will or other inter vivos instrument are given effect to the same extent as if the apportionment statute had not been enacted. Va. Code sec. 64.1-165 (1950). "The intent of the testator is the cardinal rule, and if it is made clear that [the testator] intended that there should not be an apportionment of taxes, that intent must be given effect." Simeone v. Smith, 204 Va. 860, 134 S.E. 2d 281, 283 (1964).

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In the instant case the testator directed that all death duties on his Kentucky real estate be paid by his executrix out of the assets of his estate other than the Kentucky real estate. The inclusion of this direction demonstrates the intent of the decedent to avoid the Virginia apportionment statute and to preserve the Kentucky real estate. Under Virginia law, this intent is sufficient to avoid the application of the apportionment statute. In a case involving a similar will provision, the Supreme Court of Virginia stated: "While this conclusion reduces the value of the bequest to the widow and increases the amount of the Federal estate tax, the language of the will is susceptible of no other interpretation." Baylor v. National Bank of Commerce, supra, 72 S.E. 2d at 286. The language of the will at issue in the instant case is equally clear and must be given affect.

Petitioner contends, however, that despite the language contained in the will, the Federal estate taxes attributable to the Kentucky property should be paid out of that property and argues that decedent's direction that death duties on the Kentucky real estate be paid out of assets other than said real estate did not reject the Virginia statutory apportionment rule.

Petitioner argues that decedent intended that estate taxes attributable to the Kentucky real estate should be charged against the residue of decedent's probate estate, and that when the residue of decedent's estate is exhausted, taxes must be

apportioned in accordance with Virginia law. Therefore, according to petitioner, the Kentucky real estate must bear the taxes attributable to it which exceed the residue of decedent's estate. Petitioner cites no authority for this proposition, nor have we found any. First, we note that decedent's will did not provide for payment of taxes out of the residue of his probate estate, but rather out of the assets of his estate other than the Kentucky real estate. Jointly held property is included in a decedent's gross estate under both Federal and Virginia law. Section 2040; Va. Code sec. 58.1-901 (1984). Therefore, the jointly held property is included in decedent's estate for purposes of both Federal estate taxes and Virginia inheritance taxes.

Secondly, Virginia Code section 64.1-165 provides, with respect to the apportionment statutes: "that none of such provisions shall in any way impair the right or power of any person by will * * * to make direction for the payment of such estate or inheritance taxes and to designate the fund or funds or property out of which such payment shall be made; and in every such case the provisions of the will * * * shall be given effect to the same extent as if the [apportionment statutes] had not been enacted." As stated above, the intent of the decedent is clear and must be given effect. The provision in decedent's will directing that death duties on the Kentucky real estate be paid by his executrix out of assets other than said real estate thus

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overrides the Virginia apportionment statute, and causes the will to be administered as if the apportionment statute had never been enacted. Va. Code sec. 64.1-165 (1980). Given the statutory language, we cannot agree with petitioner's argument that the will should be given effect only until the residue of decedent's probate estate is exhausted.

Petitioner argues that in order for taxes attributable to the Kentucky real property to be assessed against the joint property passing to the wife outside the will, respondent must prove that the decedent intended to preserve the Kentucky real property at the cost of forcing his wife to sell their residence to pay the death taxes attributable to said real estate. Contrary to this assertion, petitioner bears the burden of proof with respect to the claimed deduction. Rule 142(a). Petitioner correctly points out that where there is found an intention on the part of the testator that apportionment should not take place, that intent is given effect and where evidence of such intent is lacking, apportionment is applied. Simeone v. Smith, supra at 285. However, petitioner misunderstands the meaning of "intent" under Virginia law. Petitioner maintains that the intent required is the intent of decedent to force his wife to sell the family residence in order to pay the death taxes on the Kentucky real property. Under Virginia law, however, the requisite intent is merely the testator's intent that taxes not be apportioned. The tax clause at issue in the instant case

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provides such an intent. Petitioner cites no authority for its assertion that the tax clause will fail absent a showing that decedent intended that the residence be sold in order to pay the taxes on the Kentucky real property, nor have we found any.

Finally, petitioner argues that even if the decedent had explicitly expressed his intention to charge taxes attributable to the Kentucky real estate against joint property, such an expression would be ineffectual under Virginia law. In support of its contention, petitioner cites section 64.1-165 of the Virginia Code which provides that if a will provision which is contrary to statutory apportionment exists, it shall be given effect to the same extent as if the apportionment statute had not been enacted. Therefore, petitioner asserts that if decedent intended that taxes not be apportioned, common law rules should be applied. Petitioner concludes that under common law, the decedent could not defeat his spouse's right of survivorship by will.

Under common law, joint tenancy property or property held as tenants by the entireties is not subject to the will of one joint tenant, but passes to the other joint tenant by right of survivorship. However, the common law right of survivorship has been abolished in Virginia. Va. Code sec. 55-20 (1981). This section provides that any conveyance or devise of real or personal property to a husband and wife shall be treated as a tenancy in common rather than a tenancy by the entireties. Each

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spouse will be treated as if he or she had received a one-half interest in a separate conveyance. Virginia Code section 55-21, however, provides that section 55-20 shall not apply "when it manifestly appears from the tenor of the instrument that it was intended the part of the one dying should then belong to the others." In order for survivorship to exist, the deed or will conveying the interest to husband and wife must provide that survivorship is intended. Vasilion v. Vasilion, 192 Va. 735, 66 S.E. 2d 599 (1951). Although the parties stipulated that the non-probate property was held by decedent and his spouse as joint tenants by the entireties, petitioner, who bears the burden of proof on this issue, has proffered no evidence indicating that the decedent and his spouse held the property with the right of survivorship.[5]

Virginia law requires that the intent of the testator be given effect. Although the purpose of the apportionment statute is to permit the surviving spouse the maximum marital deduction under section 2056, the Virginia Supreme Court has not hesitated to reduce the amount of the decedent's estate received by the surviving spouse in order to give effect to the intent of the testator as expressed in the will. Baylor v. National Bank of Commerce of Norfolk, supra at 286. The will of the testator, in the instant case, expresses his intent that the Kentucky real

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5 While we have some reservations with respect to whether the Virginia real estate was in fact non-probate property, we do not feel justified in going behind the stipulation in this case.

property not be subject to estate taxes and this intent takes precedence over the surviving spouse's ability to claim the maximum estate tax marital deduction. Therefore, we sustain respondent's determination.

To reflect concessions of the parties and the foregoing,

Decision will be entered under Rule 155.

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T. C. Memo. 1986-164

UNITED STATES TAX COURT

JOHN A. SAMOHIN and HRYSOULA SAMOHIN, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket Nos. 8223-82, 33575-83. Filed April 22, 1986.

Fred A. Foley, for the petitioners.

Patrick J. Gray, Jr., for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

SWIFT, Judge: In timely statutory notices of deficiency and by amendment to his answers herein, respondent determined deficiencies in petitioners' Federal income tax liabilities and additions to tax, as follows:

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Docket No.	Year	Deficiencies	Additions to Tax I.R.C. Section 6653(a)[1]
8223-82	1978	$ 94,075.00	$4,658.78
33575-83	1979	145,198.10	7,259.90
33575-83	1980	14,473.65	2,864.08

These cases were consolidated by Order of this Court dated September 28, 1984.

After a partial settlement, the primary issues remaining for decision are: (1) Whether petitioners received unreported income from their sole proprietorship in 1978 and 1979 in excess of amounts conceded; and (2) whether petitioners are liable for the additions to tax set forth above.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. Petitioners John A. Samohin ("John") and Hrysoula Samohin ("Hrysoula") are husband and wife and resided in Sterling Heights, Michigan, when they filed the petitions herein. Petitioners timely filed joint Federal income tax returns for 1978, 1979, and 1980.

John is a native of Galata, Greece. He immigrated to the United States in 1967 at the age of 24. John was trained in Greece as a machinist and became employed in the United States in that capacity from 1967 through 1974 by, among others, Chrysler

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[1] All section references are to the Internal Revenue Code of 1954, as in effect during the years in issue.

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Corporation and Ford Motor Company. During those years, John became a citizen of the United States, accumulated a small savings, and worked part time to establish his own machine shop. In 1974, John resigned his employment at Ford Motor Company, and with $18,000 in savings, he began to operate his own machine shop on a full-time basis as a sole proprietor. He did business under the name of John Sam's Tool Company (hereinafter referred to as "Sam's Tool Company"). On December 23, 1980, Sam's Tool Company was incorporated under the laws of the State of Michigan.

Sam's Tool Company specialized in making customized parts for machinery and equipment used in the automotive industry. During the years in issue, Sam's Tool Company won bids from and completed jobs for five customers, namely, Chevrolet Motor Company ("Chevrolet"), F. Joseph Lamb Company ("Lamb"), O'Keller Tool Company ("O'Keller Tool"), Michigan Precision Industries, Inc. ("MPI"), and Punchcraft Company ("Punchcraft"). As the proprietor of Sam's Tool Company, John prepared the bids, participated in all aspects of the manufacturing process, supervised 12 employees, and managed all other aspects of the business.

Hrysoula is a native of Athens, Greece. Her parents, Demetrius and Maria Kateri, had been the owners and proprietors of a retail furniture store in Athens from the end of World War II until Demetrius Kateri's death in 1964. Many of the customers of the furniture store were U.S. military personnel stationed at a nearby U.S. military base. The military personnel often

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purchased furniture at the store and paid cash for the furniture with U.S. dollars. Because the value of the U.S. dollar was understood to be more stable than the value of the Greek drachma, Mr. and Mrs. Kateri accumulated the U.S. dollars earned in their business. Mr. and Mrs. Kateri agreed that the U.S. dollars they were able to save would be given to Hrysoula, their only child, as a dowry at the time of her marriage.

Upon the death of Demetrius in 1964, Mr. and Mrs. Kateri had accumulated U.S. $260,000. Mrs. Kateri inherited from her husband this money, as well as the furniture store, three apartments, and three parcels of vacant real property.

The U.S. $260,000 was kept in a locked chest in the attic of the Kateri home. In 1970, Hrysoula's mother showed her the money in the chest and explained to Hrysoula her intent eventually to give Hrysoula the U.S. $260,000. The money was wrapped in paper, tied in small bundles, and covered with old clothes. The money consisted primarily of U.S. $50 and U.S. $100 bills, but smaller denomination bills also were included.

While vacationing in Greece in the summer of 1973, John met Hrysoula and shortly thereafter, in October of 1973, petitioners were married in Athens. At the time of the marriage, Maria Kateri gave Hrysoula approximately U.S. $50,000 as part of the dowry money, and she informed Hrysoula and John that the remaining U.S. $210,000 would be given to Hrysoula over a period of time, provided the marriage was successful. In traveling to the United States with her new husband, Hrysoula hid the U.S.

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$50,000 on her person because she understood it was illegal to transport large amounts of U.S. currency outside of Greece. After petitioners arrived in the United States, Hrysoula tied the $50,000 in small bundles and hid it in a two-foot-square box in a closet in petitioners' home in Michigan.

The remaining U.S. $210,000 which Hrysoula's mother had in her home in Greece was given to Hrysoula over the next six years. In June of 1975 and in December of 1976, Maria Kateri traveled by air to the United States to visit petitioners. On each of those trips, Mrs. Kateri hid approximately U.S. $50,000 of the dowry money on her person, and upon her arrival in the United States, gave it to Hrysoula. In June of 1978 and in June of 1979, Hrysoula visited her mother in Greece. On each of those trips Hrysoula returned to the United States carrying with her approximately U.S. $50,000 of the dowry money. The money was hidden on her person in a manner similar to the manner in which she had carried the first U.S. $50,000 into the United States in 1973. Neither Mrs. Kateri nor Hrysoula reported to Greek officials or U.S. customs officials that they were transporting large amounts of U.S. currency into the United States from Greece.[2]

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[2] The international transportation of U.S currency in amounts exceeding $5,000 is required to be declared to U.S. customs officials on Customs Form 4790, Report of International Transportation of Currency or Monetary Instruments. 31 U.S.C. § 5316 (1985).

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From 1974 through 1979, Hrysoula frequently received letters from her mother containing small amounts of U.S. currency from the dowry, totaling approximately U.S. $10,000. By September of 1979, Hrysoula had received the entire U.S. $260,000 promised to her by her mother, and she received no dowry money from her mother thereafter. All of the U.S. currency Hrysoula received from her mother was kept in the same box in petitioners' home.

Hrysoula considered the dowry money her own, and she exercised complete control over the use of the money. Some was used for family vacations and necessities. Several times during the years 1973 through 1977, John asked Hrysoula to allow a portion of the dowry money to be used to expand his business. Hrysoula refused John's requests because she was not completely secure in her marriage and she did not then want to commit the dowry money to the business.

By 1977 petitioners had two children, and Hrysoula had become confident that her marriage to John would be successful. Hrysoula thereafter began to make portions of the dowry money available to John's business by depositing portions of it to the checking account of Sam's Tool Company, and she continued to do so throughout 1978 and 1979. Hrysoula also routinely made deposits to the bank accounts of Sam's Tool Company of receipts from the business. She often deposited dowry money into the checking account at the same time she deposited business receipts into the account, using the same deposit slips for all the money.

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Respondent's agent made an initial contact with petitioners in January or February of 1979 regarding an audit of their 1977 joint Federal income tax return. Petitioners heard nothing further from the agent until early 1980, by which time (because petitioners were under the impression the audit had terminated) petitioners had discarded some of their records. Some records also were destroyed when the basement in which records of Sam's Tool Company were kept was flooded.

In 1980, another of respondent's agents was assigned the audit of petitioners' 1977 return. He expanded the scope of the audit to include 1978, 1979, and, eventually, 1980 and 1981. During the audit, petitioners cooperated with respondent's agent in every respect and explained to the agent that Hrysoula had received U.S. $260,000 as a dowry from her mother and that approximately $180,000 of it had been deposited to the checking account of Sam's Tool Company in 1978 and 1979. Petitioners obtained an affidavit from Mrs. Kateri, made on May 30, 1980, in Athens, Greece, in which Mrs. Kateri stated that she had given Hrysoula U.S. $50,000 at the time of her marriage in 1973, and U.S. $210,000 periodically from 1973 to 1979.

At the conclusion of the audit, respondent issued "no-change" letters with respect to petitioners' 1977 and 1981 joint Federal income tax returns. With respect to petitioners' 1980 joint Federal income tax return, respondent's agent disallowed certain deductions made thereon, but accepted the gross receipts of Sam's Tool Company as reported for that year. With respect to

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1978 and 1979, however, respondent determined that the books and records of Sam's Tool Company did not accurately reflect the income of the business in those years. Respondent, therefore, reconstructed the income of Sam's Tool Company for 1978 based upon bank deposits made in that year to the checking account of Sam's Tool Company with the Detroit Bank and Trust Company (hereinafter referred to as the "Bank"). For 1979, respondent's reconstruction of the income of Sam's Tool Company was based not only on deposits to the checking account of Sam's Tool Company but also on deposits to its savings account, to petitioners' personal checking account, and to petitioners' two personal savings accounts.

Respondent determined that all deposits to bank accounts of Sam's Tool Company in 1978 and 1979, other than interaccount transfers, represented gross receipts of Sam's Tool Company in those years, and that those deposits, to the extent they exceeded gross receipts reported on petitioners' 1978 and 1979 joint Federal income tax returns, represented additional, unreported income of Sam's Tool Company. Respondent's determinations were reflected in his notice of deficiency, as follows:

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Year	Total Deposits[3]	Reported Gross Receipts	Amount of Unreported Income
1978	$492,118	$419,629	$ 72,489
1979	886,997	695,621	191,376

Respondent also identified certain payments to Sam's Tool Company in 1978 and 1979 that petitioners did not deposit in those years to any of the examined bank accounts. Because those amounts were not included in respondent's bank deposits analysis, those amounts (namely, $80,789 in 1978 and $31,504 in 1979), in amended answers, were determined to be additional income of Sam's Tool Company.

At trial, testimony was offered by petitioners, by Mrs. Kateri, by the Bank's vice president, and by respondent's revenue agent. A certified public accountant also offered expert testimony for petitioners concerning, among other things, the estimated gross receipts of Sam's Tool Company in 1978 and 1979.

OPINION

The primary issue in these consolidated cases requires a factual determination of the source of certain deposits made to bank accounts of Sam's Tool Company in 1978 and 1979. Respondent contends that, excluding interaccount transfers, all deposits to the checking account of Sam's Tool Company in 1978 and to its

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3 "Total deposits" represent total deposits to the bank accounts used in respondent's bank deposits analysis less deposits attributable to interaccount transfers.

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checking and savings accounts in 1979, represent business income of Sam's Tool Company. Petitioners do not dispute that they inadvertently may have failed to report on their Federal income tax returns for the years in issue deposits to the bank accounts totaling $24,670 in 1978 and $81,383 in 1979. Petitioners contend, however, that certain additional deposits to the bank accounts (namely, $49,121 in 1978 and $128,352 in 1979) are attributable to the dowry received from Mrs. Kateri and are excludable from gross income under section 102(a).[4]

As a preliminary matter, the parties herein dispute whether petitioners or respondent bears the burden of proof as to the amount and taxability of deposits made to bank accounts of Sam's Tool Company that were not included in petitioners' Federal income tax returns. In light of our resolution of this issue on the merits, a decision herein as to the placement of the burden of proof would not affect our decision. We need not and do not decide that issue.

Respondent's use of the bank deposits method for computing income has long been sanctioned by this and other courts. See Estate of Mason v. Commissioner, 64 T.C. 651, 656 (1975), affd. 566 F.2d 2 (6th Cir. 1977), and cases cited therein. Bank deposits are prima facie evidence of income. Estate of Mason v.

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4 SEC. 102. GIFTS AND INHERITANCES.

(a) General Rule.--Gross income does not include the value of property acquired by gift, bequest, devise, or inheritance.

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Commissioner, supra; Hoefle v. Commissioner, 114 F.2d 713 (6th Cir. 1940), affg. a Memorandum Opinion of this Court. A likely taxable source is present in this case for deposits to the bank accounts of Sam's Tool Company (namely, business receipts of Sam's Tool Company). Holland v. United States, 348 U.S. 121, 138 (1954).

Whether unexplained deposits to the bank accounts of Sam's Tool Company constitute nontaxable gifts to petitioners or taxable receipts of the business is a question of fact. Commissioner v. Duberstein, 363 U.S. 278, 289 (1960); Smith v. Commissioner, 305 F.2d 778, 780 (3d Cir. 1962), affg. a Memorandum Opinion of this Court. In Commissioner v. Duberstein, supra, the Supreme Court commented on the imprecise nature of such a factual determination as follows:

> Decision of the issue presented in these cases must be based ultimately on the application of the fact-finding tribunal's experience with the mainsprings of human conduct to the totality of the facts of each case. The nontechnical nature of the statutory standard, the close relationship of it to the data of practical human experience, and the multiplicity of relevant factual elements, with their various combinations, creating the necessity of ascribing the proper force to each, confirm us in our conclusion that primary weight in this area must be given to the conclusions of the trier of fact. * * * [363 U.S. at 289.]

Respondent points to a number of factors which he contends highlight the implausibility and incredibility of petitioners' assertion that they received a cash dowry in the amount of U.S. $260,000 and that a substantial portion of the dowry was

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deposited to the bank accounts of Sam's Tool Company in 1978 and 1979. Respondent contends that it is unlikely that Demetrius and Maria Kateri's retail furniture store in Athens, Greece, which was sold for the equivalent of U.S. $5,000 or $6,000, could generate $260,000 in U.S. currency. Further, respondent notes that $50 and $100 bills are not widely circulated today and were, no doubt, less likely to have been circulated during the years 1945 through 1964.

Respondent points out that the deposit slips do not indicate that cash was deposited to the bank accounts and that if petitioners had made cash deposits on certain occasions in excess of $10,000, as they allege they did, the Bank would have been obligated to complete and file with Federal authorities a "currency transaction report" reflecting each such deposit. Since the Bank did not file any currency transaction reports with respect to deposits in excess of $10,000 made by petitioners, respondent argues that no cash deposits in excess of $10,000 were made by petitioners.

Respondent contends further that if petitioners did receive gifts of cash from Mrs. Kateri, it is unlikely they would have deposited the cash to the checking account of Sam's Tool Company in odd-dollar amounts (such as $1,028 deposited on February 10, 1978, or $5,481 deposited on April 30, 1979), rather than in round-numbered amounts. Respondent argues that the pattern of deposits of alleged dowry money made by petitioners is virtually

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indistinguishable from the pattern of deposits made by petitioners of checks received from customers of Sam's Tool Company.[5]

Respondent also points out that on four separate occasions deposits of alleged dowry money were recorded as two separate amounts on the same deposit slips.[6] Respondent argues that deposits from the same source (namely, the dowry gift) likely would not have been recorded on a single deposit slip as two separate odd-dollar amounts.

Petitioners are not the first to assert before this Court that they were beneficiaries of large cash gifts or inheritances which they secreted away for many years.[7] Regardless of who bears the burden of proof in a particular case, such claims must be scrutinized carefully. We have so examined the totality of the facts and circumstances before us in this case and the credibility of the actions and testimony of petitioners herein and of Mrs. Kateri. Having done so, we believe that petitioners

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5 For a listing of bank deposits which petitioners contend are deposits of dowry money see Appendix.

6 See Appendix, with respect to deposits made on December 14, 1978, March 6, 1979, March 14, 1979, and October 15, 1979.

7 See, for example, Salladay v. Commissioner, T.C. Memo. 1985-86; Sammons v. Commissioner, T.C. Memo. 1984-414; J.S.M. Enterprises, Inc. v. Commissioner, 1984-269; Varano v. Commissioner, T.C. Memo. 1984-135; Mahigel v. Commissioner, T.C. Memo. 1983-529; Tucker v. Commissioner, T.C. Memo. 1983-456.

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did receive a dowry from Mrs. Kateri in the amount of U.S. $260,000, and that a significant portion thereof was deposited to the bank accounts of Sam's Tool Company in 1978 and 1979.

Hrysoula's testimony with respect to the manner of and the reasons for transporting, storing, and depositing funds received from her mother was entirely credible. The testimony of John and particularly of Hrysoula's mother, also was completely credible. Their testimony is supported by the customs within the Greek community (as explained by petitioners) for parents to give dowries to newly married children. It is supported by the presence of the retail furniture store in Greece which did business for many years in U.S. dollars with U.S. military personnel. It is supported by the death of Hrysoula's father and the relationship between the dowry and the intent of Hrysoula's father and mother to transfer a portion of their estate to Hrysoula. The mode of transporting the funds out of Greece into the United States and the reasons therefor were candidly and forthrightly explained and were entirely believable. Petitioners' testimony also was consistent with the explanations petitioners gave to respondent's agents from the initiation of the audit.

The points raised by respondent are not necessarily inconsistent with petitioners' assertion that they made deposits of dowry money to the bank accounts of Sam's Tool Company. It is common knowledge, and the Bank's vice president acknowledged in his testimony herein, that banks often fail to report cash

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transactions in excess of $10,000. The Bank's vice president also testified that tellers employed at the Bank often fail to correct deposit slips on which cash deposits erroneously are recorded in the space provided for deposits of checks. We have no reason to doubt the truthfulness of the vice president's testimony, and respondent has pointed to none.

In explanation for the fact that amounts deposited to the checking account of Sam's Tool Company were odd amounts, petitioners testified that they tied the money they received from Mrs. Kateri in bundles of varying size and amount, and placed the bundles of money in a storage box in their home. When Hrysoula or John made a deposit of dowry money, they simply would take one or two bundles of the money to the Bank, count it, and record the amount of each bundle on a separate line of the deposit slip.

The credibility of petitioners' testimony is further corroborated by a comparison of total payments to Sam's Tool Company (established by respondent through contacts made with the companies doing business with Sam's Tool Company) with total gross receipts of Sam's Tool Company reported on Schedule C of petitioners' tax returns for 1977 through 1980. That comparison is reflected below:

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Year	Total Payments As Per Customers of Sam's Tool Company	Total Gross Receipts Reported on Tax Returns
1977	$277,364	$277,364
1978	428,790	419,629
1979	763,432	695,621
1980	583,169	583,169

We note that a high percentage of the total gross receipts established through contacts with customers of Sam's Tool Company was reported on petitioners' tax returns. If the additional $260,000 in deposits to the bank accounts actually represented receipts from customers, as respondent claims, one would have expected that such a contention would have been borne out in the information respondent received from the customers.

Petitioners have been forthright in their concession of certain amounts of unreported income (namely, $9,670 in 1978 and $71,463 in 1979) and have conceded additional amounts (namely, $15,000 in 1978 and $10,000 in 1979), as an estimate of unreported receipts earned by Sam's Tool Company from O'Keller Tool. If petitioners were fabricating the entire Greek dowry story, it is likely they would have claimed all of the amounts determined by respondent to be unreported income of Sam's Tool Company in 1978 and 1979 to be part of the nontaxable dowry. We reiterate that from petitioners' first contacts with respondent's agents until the time of trial, petitioners have provided the same, consistent explanation for amounts determined by respondent to be unreported receipts.

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Through the testimony of a certified public accountant, petitioners offered evidence that an accounting error was made in 1980 by petitioners' former tax return preparer in converting the books of Sam's Tool Company from an accrual basis for financial purposes to a cash basis for tax purposes. The accountant then opined that if the same error that was made in 1980 by the tax return preparer was made in 1978 and 1979 when he prepared petitioners' tax returns for those years, the gross receipts of Sam's Tool Company reported on the tax returns for those years would have been understated by amounts that are not significantly different from the amounts petitioners now concede were incorrectly omitted from the tax returns.

The certified public accountant also testified that for the years 1980 through 1983, the average labor cost of Sam's Tool Company was 21.52 percent of gross receipts. Using the undisputed labor costs for the years 1978 and 1979, and projecting gross receipts therefrom on the basis of the same factor of 21.52 percent, the accountant estimated that actual gross receipts from the business were $451,138 in 1978 and $732,365 in 1979. Those amounts are close to the gross receipts reported on the tax returns (namely, $419,629 in 1978 and $695,621 in 1979). The inference, of course, that can be drawn from the above testimony is that, with the exception of amounts conceded by petitioners, the tax returns generally reported the correct gross receipts of Sam's Tool Company and that the significant deposits to the bank accounts in excess of reported

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gross receipts came from a source other than the business. We do not necessarily accept the testimony of the accountant as correct, but we do note its tendency to further corroborate petitioners' testimony concerning the nontaxable source of significant deposits to the bank accounts.

Based upon all of the evidence, we conclude that of the deposits made to the bank accounts of Sam's Tool Company, $47,819 in 1978 and $109,993 in 1979 represented nontaxable funds received by petitioners from Mrs. Kateri as a dowry. The balance of the deposits made to the bank accounts (namely, $24,670 in 1978 and $81,383 in 1979) have not been shown to be nontaxable receipts, and petitioners no longer contest the taxability thereof.

In addition, in amended answers, respondent has identified additional receipts of Sam's Tool Company in 1978 ($80,788.97) and 1979 ($31,504) which were not deposited into the bank accounts and therefore were not part of the bank deposits analysis. Petitioners do not seriously contest the taxability of these additional receipts. We find that they are taxable to petitioners in the year of receipt.

Also in an amended answer, respondent alleges that an additional $1,526 was deposited to the savings account of Sam's Tool Company in 1979, and respondent alleges that the $1,526 constitutes additional income to petitioners. Petitioners again do not seriously contest the taxability in 1979 of this additional amount deposited to their savings account. They point

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out, however, that the correct amount of these additional deposits is $1,466.08, not $1,526. We find that the correct amount of the additional deposits to the savings account was $1,466.08. That amount is also taxable to petitioners in 1979.

Of the $31,504 that was not deposited into the bank accounts and that we have determined represents additional income of Sam's Tool Company, petitioners point out that two checks totaling $16,088 (one from Chevrolet in the amount of $10,922 and one from Lamb in the amount of $5,166) were cashed by petitioners in 1980. They contend that the $16,088 received when the checks were cashed in 1980 was included in the reported gross receipts of Sam's Tool Company for 1980. Because the $16,088 is now being included in petitioners' taxable income for 1979, they contend that it should be eliminated from their taxable income for 1980. Respondent contends that petitioners are not entitled to this reduction in the income of Sam's Tool Company for 1980 because no specific showing has been made by petitioners that the $16,088 actually was included in the income reported on petitioners' 1980 tax return. Unfortunately, petitioners have presented no evidence from which we can conclude that the $16,088 was included in the computation of the reported income of Sam's Tool Company for 1980. We sustain respondent on this issue.

During the years at issue, petitioners acquired for use in the business of Sam's Tool Company certain tangible assets. Petitioners properly deducted depreciation with respect to those assets under the straight-line method. Petitioners now contend

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that they should be allowed to change their method of computing depreciation on those assets to the double-declining-balance method and to increase their deductions for depreciation with respect to those assets by $4,340.00, $15,844.28, and $16,706.43 in 1978, 1979, and 1980, respectively.

Respondent contends that once an acceptable method of depreciation is used by a taxpayer which results in a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in a trade or business, that method must consistently be applied thereafter to that item. Sec. 1.167(b), Income Tax Regs. Prior to any change in the method of computing depreciation, petitioners must obtain respondent's consent thereto. Sec. 446(e). Wildman v. Commissioner, 78 T.C. 943, 952 (1982); Mitchell v. Commissioner, 42 T.C. 953, 968 (1964). Petitioners offered no evidence that they obtained respondent's consent to a change in their method of calculating depreciation. We sustain respondent on this issue.

Finally, respondent determined additions to tax under section 6653(a) for negligence or intentional disregard of rules

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and regulations.[8] Petitioners concede that they failed to report a significant amount of gross receipts of Sam's Tool Company on their Federal income tax returns for 1978 and 1979, which resulted in significant understatements of their tax liabilities. Petitioners' explanations for the omissions were not adequate, and we sustain respondent's imposition of the additions to tax under section 6653(a).

Decisions will be entered under Rule 155.

---

[8] As in effect in 1978, sec. 6653(a) provided:

> (a) Negligence or Intentional Disregard of Rules and Regulations With Respect to Income or Gift Taxes.--If any part of any underpayment (as defined in subsection (c)(1)) of any tax imposed by subtitle A or by chapter 12 of subtitle B (relating to income taxes and gift taxes) is due to negligence or intentional disregard of rules and regulations (but without intent to defraud), there shall be added to the tax an amount equal to 5 percent of the underpayment.

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APPENDIX

The following is a list only of deposits made by petitioner to the checking account of Sam's Tool Company that were not specifically associated with a payment received from one of the customers of Sam's Tool Company. An identification is made of those deposits that petitioners contend represent deposits of dowry money.

Deposits Made in 1978	Amount	Deposits Petitioners Identify as Dowry	Deposits Made in 1979	Amount	Deposits Petitioners Identify as Dowry
January 19	$21,249.19		January 04	$ 1,572.00	Dowry
February 01	887.50		17	635.60	
10	1,797.50		17	3,302.00	Dowry
10	1,994.89		February 16	2,598.70	
10	1,028.00	Dowry	16	967.00	
March 03	20,211.47		26	3,166.00	Dowry
23	3,165.00	Dowry	March 05	2,154.00	Dowry
April 26	480.00		05	3,890.00	Dowry
26	1,194.00		14	2,781.00	Dowry
26	4,650.00	Dowry	14	3,413.00	Dowry
26	600.00		27	5,213.00	Dowry
May 05	1,800.00		April 12	954.00	
05	414.00		18	3,039.00	Dowry
12	1,538.70		28	5,481.00	Dowry
17	2,546.00		May 11	2,020.00	Dowry
31	382.00		16	289.05	
June 08	3,290.00	Dowry	16	4,160.00	Dowry
15	3,224.60		June 01	119.00	
July 06	7,494.00	Dowry	01	2,201.00	Dowry
06	277.00		14	4,465.00	Dowry
13	5,249.00	Dowry	21	7,017.00	Dowry
13	220.00		26	17,699.00	Dowry
August 16	5,864.50		July 12	5,264.50	
September 05	307.50		August 16	12,030.00	Dowry
05	280.00		23	1,313.00	Dowry
14	2,598.00		28	658.00	
15	457.00		28	800.00	
21	2,000.00	Dowry	28	104.00	
27	7,462.70		28	1,462.00	Dowry

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Deposits Made in 1978	Amount	Deposits Petitioners Identify as Dowry
October 06	882.50	
18	2,717.00	Dowry
30	4,109.50	
20	164.00	
November 10	350.00	
15	4,033.00	Dowry
15	290.00	
27	100.00	
December 01	9,029.00	
14	1,712.00	
14	5,585.00	Dowry
14	9,910.00	Dowry

Deposits Made in 1979	Amount	Deposits Petitioners Identify as Dowry
September 10	2,431.00	Dowry
13	64.00	
13	3,860.50	
October 12	4,007.00	Dowry
12	5,745.00	Dowry
12	39.20	
12	762.50	
12	189.00	
26	34.00	
26	443.00	
November 09	5,315.00	Dowry
09	289.00	
16	630.00	
16	118.00	
26	2,356.50	
December 15	24,476.00	Dowry

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UNITED STATES TAX COURT

SALYER GRAIN AND MILLING COMPANY, Petitioner v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 21449-80. Filed April 22, 1986.

Gary S. Vandeweghe, for the petitioner.

Catherine L. Wong and Alan Summers, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

CLAPP, Judge: Respondent determined a deficiency in petitioner's Federal income tax in the amount of $288,000 for taxable year 1974. After concessions, the issue for decision is whether $600,000 of a $1.4 million payment by petitioner to Fred Greer constitutes consideration for the cancellation of an

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employment contract or whether all of the $1.4 million payment is allocable to a sale of stock. Petitioner claimed $600,000 as an ordinary and necessary business expense on its July 30, 1977 fiscal year tax return. This in turn resulted in a NOL carryback to petitioner's 1974 tax return which was disallowed by respondent.

FINDINGS OF FACT

Some of the facts have been stipulated and are found accordingly. The stipulation of facts and attached exhibits are incorporated herein by this reference.

Petitioner, Salyer Grain and Milling Co., is a California corporation which had its principal place of business in Corcoran, California at the time the petition was filed. At all times relevant to this proceeding, brothers Fred Salyer (Fred) and Everette C. Salyer (Everette) were principal stockholders and officers of petitioner and Salyer Land Co. (Salyer Land).

On July 22, 1972, Thomas Keister Greer, Esquire (Greer) purchased 85 shares of Salyer Land stock and 34,553.8 shares of petitioner's stock. Also on July 22, 1972, Greer entered into an employment contract with petitioner and Salyer Land. Under this contract Greer, an attorney who had been representing the two corporations since 1957, agreed to devote all of his professional time to petitioner and Salyer Land in exchange for a permanent retainer of $100,000 a year, to continue for as long as he lived provided that he could be retired at any time at one-half of that

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sum, and a twenty-year retainer of $65,000 a year. If Greer sold his stock in Salyer Land all obligations to pay retainers, retirement income or pension would cease.

Sometime in 1975, differences arose between Greer and the Salyer brothers which led Greer to decide that he no longer wished to be a shareholder. During 1975 and early 1976 negotiations were conducted directly between Greer and the Salyer brothers regarding the sale to petitioner by Greer of the stock he acquired in 1972. In the spring of 1976, petitioner consulted Mr. John Penn Lee with respect to this matter. Mr. Lee, an attorney with a Master of Laws in Taxation, had been working on tax matters for petitioner. In March 1976, Greer hired Baxter Richardson, Esquire, an attorney and a certified tax specialist, to represent him in this matter.

On July 17, 1976, petitioner sent a letter to Greer which stated:

> The Executive Committee of the Board of Directors of the Salyer Grain & Milling Company hereby offer to redeem and purchase your stock in the Salyer Grain & Milling Company and Salyer Land Company for the sum of $1.4 million.
>
> The company is advised that the stock's actual market value is less than such figure but, in view of the threatened litigation and the disruptive effects on company operation and its personnel, the Executive Committee feels the offer is in the company's best interest.
>
> This offer is conditioned upon your resignation as a director of the companies and a release of all claims against Salyer Land Company, Salyer Grain & Milling Company, and the officers, shareholders, attorneys, accountants and personnel of both companies. * * *

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Greer initially rejected the offer but subsequently accepted it.

Lee never proposed a value for the employment contract and the subject of an allocation was not brought up between the parties. Greer instructed Richardson that all of the $1.4 million payment was to be in payment for stock. Greer would not have accepted this amount if he had known petitioner would allocate $600,000 to the employment contract.

On July 28, 1976 at 9:30 a.m. petitioner's Executive Committee of the Board of Directors held a special meeting at the airport in Fresno, California. As stated in the minutes, the purpose of the meeting was to review the negotiations with Greer and to vote on the offer of Greer to sell his stock for a total price of $1.4 million. At the end of the special meeting petitioner's Executive Committee adopted the resolution that:

> RESOLVED, that upon Thomas Keister Greer's warranty to the Company that he is the sole owner of the stock; that the Salyer Grain & Milling Company accept the offer of Thomas Keister Greer to sell and the Company to purchase his stock in the Salyer Land Company and the Salyer Grain & Milling Company, being 85 shares and 34,554.8 shares, respectively, for a total price of 1.4 million dollars; and
>
> BE IT FURTHER RESOLVED, that the Company accept Thomas Keister Greer's resignation as one of its Officers and Directors; and
>
> BE IT FURTHER RESOLVED, that the Company, in conjunction with the Salyer Land Company, terminate the employment contract with Thomas Keister Greer, and in the future employ him on a case by case basis, at an hourly rate, as negotiated from time to time by the parties, billable monthly.

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Shortly thereafter on July 28, 1976, at Richardson's offices, petitioner and Mr. and Mrs. Greer entered into an Agreement and Escrow Instructions. This agreement in pertinent part provides:

> PARTIES:
>
> The parties to this agreement are THOMAS KEISTER GREER, sometimes hereinafter referred to as "GREER," and SALYER GRAIN & MILLING COMPANY, a corporation, hereinafter sometimes called the "Corporation."
>
> RECITATIONS:
>
> 1. GREER owns 85 shares of the capital stock of SALYER LAND COMPANY and 34,553.8 shares of the capital stock of Corporation. GREER desires to sell to Corporation and Corporation to purchase from GREER all of such shares.
>
> 2. The parties desire to arrange for the termination of that certain contract of July 22, 1972, between THOMAS KEISTER GREER, therein referred to as "Tom," SALYER LAND COMPANY, therein referred to as "Land Company," and SALYER GRAIN & MILLING COMPANY, therein referred to as "Milling Company," providing for the rendition of certain legal services by Tom to said corporations and payments by them.
>
> 3. The parties further wish to provide for resolution of all disputes or claims as between them and also other parties related to Corporation.
>
> AGREEMENT:
>
> In consideration of the premises, the parties agree as follows:
>
> 1. SALE AND PURCHASE OF STOCK.
>
> (a) GREER agrees to sell to Corporation and Corporation to purchase from GREER, for a total consideration of $1,400,000.00, 85 shares of capital stock of SALYER LAND COMPANY and 34,553.8 shares of the capital stock of Corporation[.] Such shares are all the issued and outstanding capital stock of said two corporations owned by GREER. To carry out such

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sale and purchase, an escrow shall be forthwith established and promptly closed as provided in paragraph 2 below.

* * *

2. ESCROW. To carry out the transaction for sale and purchase of shares provided for in paragraph I above, an escrow shall be forthwith opened with RICHARDSON AND GASKILL, Attorneys, 914 Helm Building, Fresno, California 93721.

GREER shall promptly deposit in such escrow the following:

(1) Assignments separate from certificates covering all certificates evidencing the shares of stock which are the subject matter of the transaction of sale and purchase.

(2) Release, in form satisfactory to counsel for the Corporation, of the Corporation, SALYER LAND COMPANY, EVERETTE SALYER, FRED SALYER, BASIN FARMS, a corporation, JOINT VENTURE B, a joint venture, SALYER FARMS AIRPORT, a corporation, SALYER FARMS, a partnership, and SALYER LEASING COMPANY, a partnership, and their personnel, accountants and counsel. Such release shall specifically, without limitation upon the generality of the effect thereof, be a release of all obligations of any of the parties under the said contract of July 22, 1972, between THOMAS KEISTER GREER, SALYER LAND COMPANY and SALYER GRAIN & MILLING COMPANY.

Paragraph 1(a) as originally drafted by Richardson contained at the end of the first sentence after "Corporation" the words "allocable $ _____ to said 85 shares of Salyer Land Company and $ _____ to said 34,553.8 shares of Corporation." These words were deleted and initialled by the parties on July 28, 1976. Mutual releases were executed by the parties, releasing each other from various claims and obligations, including the obligations under the employment contract.

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While Lee negotiated on behalf of petitioner he did not execute the Agreement because he was away taking the California bar examination. Gary Vandeweghe, an attorney with a principal part of his practice in the area of tax law, reviewed the documents on petitioner's behalf. Vandeweghe had been informed by Lee as to the progress of the negotiations.

Petitioner wanted to retain Greer on a case by case basis in order to continue Greer's representation in eight cases which were in the midst of litigation. The parties executed an agreement later in the day of July 28, 1976, which was not reviewed by petitioner's counsel, which set forth the terms of Greer's continued representation. The first paragraph of this agreement contained in a letter from Greer to petitioner states the following:

> As of the date hereof that contract for legal services of July 22, 1972, by and between Salyer Land Company, Salyer Grain & Milling Company, and Thomas Keister Greer has been terminated. The consideration moving from me to you for such termination is my agreement, evidenced by a separate release document executed by my wife and myself, that you are released from any and all further liability for any payment whatsoever under that agreement, accruing after the date hereof. The consideration moving from you to me for such termination is that you have released me from any and all liability to perform further and exclusive services as required therein.

No IRS Form 1099 or the like, such as a Form W-2 was ever issued to Greer by petitioner, informing Greer that petitioner was treating $600,000 of the $1.4 million as payment for his employment contract.

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In June 1977, petitioner consulted Richard Firestone, an actuary, to give an opinion as to the present value of the future payments due under the employment contract. Firestone estimated the present value to be between $1.4 million and $1.6 million.

OPINION

The issue for decision is whether any portion of the $1.4 million paid by petitioner to Greer pursuant to the agreement of July 28, 1976, constituted consideration for the cancellation of the employment contract. Petitioner contends that $600,000 of the $1.4 million is allocable to the contract and that this amount is deductible as an ordinary and necessary business expense under section 162. Petitioner argues that the agreement contains no allocation of the $1.4 million. Because the parties failed to agree to an allocation and the employment contract has some value, an amount of $600,000 should be so allocated. Respondent, on the other hand, contends that none of the $1.4 million is allocable to the employment contract. Respondent claims that the agreement unequivocally allocated all of the $1.4 million to the purchase of the stocks and that petitioner has failed to establish that the parties intended to allocate any portion to the employment contract.

We agree with respondent that the terms of the written agreement are clear that no amount of the purchase price is to be allocated to the employment contract. Paragraph one of the Agreement and Escrow Instructions specifically states that the sum of $1.4 million is the total consideration for the stocks.

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The agreement subsequently provides under the escrow instructions in paragraph two that the parties would release each other from all obligations under the employment contracts. No other consideration is specified for the termination of the employment contract.

Where the taxpayer has executed a written agreement that provides for the specific terms of a transaction in which the tax consequences are at issue, he must adduce "strong proof" to establish a position at variance with the clear language of his written agreement. Lucas v. Commissioner, 58 T.C. 1022, 1032 (1972).[1] The taxpayer must show by such proof that the asserted

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[1] Respondent urges us to apply the parol evidence rule to exclude all extrinsic evidence which would alter or contradict the terms of the agreement and, in the alternative, to apply the standard of proof adopted by the Third Circuit in Commissioner v. Danielson, 378 F.2d 771 (3d Cir. 1967), vacating and remanding 44 T.C. 549 (1965), that:

> a party can challenge the tax consequences of his agreement as construed by the Commmissioner only by adducing proof which in an action between the parties to the agreement would be admissible to alter that construction or to show its unenforceability because of mistake, undue influence, fraud, duress, etc. * * * [378 F.2d at 775]

The Danielson rule encompasses the parol evidence rule. See Commissioner v. Danielson, supra at 779; Schmitz v. Commimssioner, 51 T.C. 306, 317, affd. sub nom. Throndson v. Commissioner, 457 F.2d 1022 (9th Cir. 1972). The present case is appealable to the Ninth Circuit which has applied the strong proof rule. Schulz v. Commissioner, 294 F.2d 52, 55 (9th Cir. 1961) affg. 34 T.C. 235 (1960). The Ninth Circuit has suggested subsequently that it might apply a stricter standard of proof akin to Danielson. Palo Alto Town & Country Village, Inc. v. Commissioner, 565 F.2d 1388, 1390 (9th Cir. 1977), affg. in part and revg. in part a Memorandum Opinion of this Court; Baxter v. Commissioner, 433 F.2d 757, 759 (9th Cir. 1970), affg. a Memorandum Opinion of this Court. However, this question was expressly left open in Throndson v. Commissioner, supra at 1025.
(footnote continued)

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allocation better represents the intention of the parties and the underlying economic realities. Major v. Commissioner, 76 T.C. 239, 247 (1981); Lucas v. Commissioner, supra at 1032-1033.

Petitioner has failed to show that the parties intended to allocate any portion of the $1.4 million to the cancellation of the employment contract. The agreement itself does not assign any value to the termination of the contract. This fact alone is good evidence that none was intended. Annabelle Candy Co. v. Commissioner, 314 F.2d 1, 7 (9th Cir. 1962). Lazisky v. Commissioner, 72 T.C. 495, 503-504 (1979), affd. on another issue sub nom. Magnolia Surf, Inc. v. Commissioner, 636 F.2d 11 (1st Cir. 1980). Both parties were represented by experienced counsel who understood the tax ramifications of the agreement. The evidence is clear that Greer would have requested a larger sum of money if any allocation had been made to the employment contract. The record is also clear that the parties never discussed any allocation of money to the contract. The fact that the parties disagreed about the allocation of the $1.4 million between the two stocks does not show, as petitioner contends, that the parties disagreed about the allocation to the employment contract. The parties never discussed an allocation to the

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(footnote continued from previous page)
This Court has not adopted the Danielson rule. See Schmitz v. Commissioner, supra at 316-318. In light of our preference for the strong proof rule we have continued to apply it in cases appealable to the Ninth Circuit. Ehlert v. Commmissioner, T.C. Memo. 1985-479. The result in this case is the same under either rule.

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employment contract. The letter of July 17, 1976 written by Everett Salyer to Greer offering $1.4 million for the stock does not mention the employment contract. This focus on the sale by the parties is understandable inasmuch as the employment contract would automatically terminate with the sale. The resolution adopted by petitioner's Executive Committee on the same day that the written agreement was signed also reflects that the entire $1.4 million was to represent the purchase price for the stock. The letter of July 28, 1976, written by Greer to petitioner, specifically recites the mutual releases from the employment contract as separate independent consideration. Although this agreement was not reviewed by petitioner's counsel, it is consistent with the written agreement executed earlier. After execution of the agreement, petitioner unilaterally allocated almost one-half of the purchase price to the employment contract on its tax return. Such an allocation, which was to petitioner's advantage and to Greer's disadvantage, was done without his knowledge or consent.

Petitioner has also failed to show that the agreement does not comport with economic reality. Petitioner's expert estimated the present value of the future payments due under the employment contract to be approximately $1.4 million to $1.6 million. While this report may be a reasonable estimate of the present value of future payments, we do not believe that we are bound to accept this valuation as proof as to what the value of the termination of the employment contract was to the parties. To so accept this

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value would result in no portion of the purchase price being attributable to the stocks. Also, the report does not take into account the terminating clause in the employment contract nor does it take into account the value to Greer of allowing him to pursue other professional endeavors. By the execution of the mutual releases, petitioner was no longer obligated to pay Greer retainers and Greer, in turn, was released from his obligation to provide services to petitioner.

Petitioner principally relies on Kinney v. Commissioner, 58 T.C. 1038 (1972) and Wood v. Commissioner, T.C. Memo. 1975-189. The former involved the sale of an insurance agency. Under the terms of the contract of sale Mr. Kinney transferred to the purchaser the office furniture and fixtures, the goodwill of the agency, the right to use the agency name, the right to the expirations of all insurance policies written by the agency and a covenant not to compete. The purchaser agreed to pay $5,000 for the office furniture and fixtures, $10 for goodwill, $10 for use of the agency name and $125,000 as the balance of the amount payable by the purchaser. Petitioner Kinney argued either no amount or a nominal amount was allocable to the covenant not to compete, while respondent argued that the covenant not to compete had independent economic significance and that a major portion of the purchase price was allocable thereto.

This Court found that the parties failed to allocate any of the consideration to the covenant because they could not agree on the amount to be allocated:

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> Since the failure to allocate was due to such disagreement between the seller and the purchaser, the absence of the allocation does not indicate that they considered the covenant to have no value. * * * As a party is not attempting to vary the language of the agreement, we do not have a situation in which the "strong proof" test is applicable. * * * [58 T.C. at 1043.]

Here, however, we do have a party attempting to vary the written agreement which expressly allocates the entire amount to the stocks. Petitioner has failed to adduce strong proof to warrant an allocation of the payment to the termination of the employment contract.

Petitioner also relies on Wood v. Commissioner, supra. In that case, the taxpayer entered into 20-year employment contracts with TSI, a life insurance and real estate holding company in 1966 and with TNLI, an insurance company and subsidiary of TSI, in 1964. The contracts provided for certain payments to the taxpayer if the contracts were terminated. The taxpayer and his family also owned a 15 percent stock interest in TSI. In 1969, American Pyramid Cos., Inc. (American) initially proposed to purchase the stock from the taxpayer for $2.75 a share, to settle the employment contracts for $300,000 and to retain the taxpayer as a part-time employee. The taxpayer agreed in principle to this proposal subject to receiving his counsel's opinion. More negotiations were conducted and a second offer was made. American would purchase the stock for $4.00 a share and the taxpayer would release American from the employment contracts. An agreement was written covering the sale of the taxpayer's stock to American. There was no discussion with respect to how

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the purchase price was to be allocated. The taxpayer reported capital gain on the stock based on the amount realized of $4 a share. Respondent determined that $300,000 of the amount realized represented consideration for the cancellation of the employment contracts and, accordingly, decreased the taxpayer's capital gain and increased ordinary income. This Court stated:

> When the terms of an agreement result from deliberate negotiations this Court is not prone to give it a different interpretation. However, when the agreement neither conforms to the business or economic realities of the situation nor is the product of conflicting tax interests, we believe it is appropriate for this Court to examine the surrounding circumstances and make our own determination. * * * [Citations omitted; emphasis added. 34 T.C.M. at 820; 44 P-H Memo T.C. at 802-75.]

The lack of agreement about the allocation was due at least in part to the fact that American did not have a stake in the allocation of the purchase price. Here, the parties had directly competing tax interests and were represented by counsel who understood the tax consequences. We are, therefore, unwilling to upset the bargain they made in light of the lack of strong proof that the agreement does not conform to business or economic reality.

We believe the facts in this case are more analogous to those in Butter-Nut Foods Co. v. Commissioner, T.C. Memo. 1965-285, affd. sub nom. Coca-Cola Company v. Commissioner, 369 F.2d 913 (8th Cir. 1966), where the taxpayer company purchased stock from a minority shareholder group of Penndale, Inc. The group included William Scull who had an employment contract with Penndale. The parties agreed to a lump-sum figure of $350,000

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which was divided amongst the individuals in the shareholder group according to their stock interest. A written agreement was executed for the sale of stock which stated the consideration of $350,000. As part of the same transaction the taxpayer and Scull executed a second agreement terminating Scull's employment contract. After execution of the agreement, Penndale's board of directors unilaterally resolved that the company purchase Scull's contract for $109,000. Penndale then allocated $109,000 of the $350,000 stock purchase price to the cancellation of the employment agreement and accrued that amount as an expense on its book. Scull attributed his share of the entire purchase price to the stock purchase and reported capital gain accordingly. In Scull v. Commissioner, T.C. Memo. 1964-224, this Court found as a fact that none of the $350,000 purchase price was allocable to the employment contract. In Butter-Nut Foods Co. v. Commissioner, supra, the same finding was made. The manner in which the lump-sum figure was distributed among the shareholders including Scull according to their respective stock interests, was a factor in this decision. Another factor, however, was that there was no consideration stated for the employment contract except the signing of mutual releases. The company was relieved of the obligation to pay Scull the money each year and Scull was free to pursue the outside interests he had acquired. The company's counsel was aware that if they amended the agreement to alter its tax consequences the sale might fall through--"the contemplated tax results were actually part of the bargain." The

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board's action in unilaterally assigning an amount to the employment contract without furnishing a Form 1099 to Scull was not the result of an agreement between the parties that any of the purchase price was allocable to the cancellation of the employment contract.

Here, the stated consideration for cancellation of the employment contract was the signing of the mutual releases. If petitioner had attempted to alter this agreement by allocating a portion to the contract, Greer would have requested more money. The unilateral action of petitioner in assigning an amount to the employment contract in no way reflected the agreement of the parties. In sum, the agreement is clear and unambiguous. The entire $1.4 million is allocable to the purchase price of the stock. The record does not justify amending this agreement executed by the parties who negotiated at arm's length, who had conflicting tax interests and who were represented by tax counsel. Accordingly, we sustain respondent's determination.

Decision will be entered for respondent.

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